

Financial Ratios I

Financial Ratios

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Question 1

Liquidity ratios use receivables and inventories of the company which times are misleading especially when the sales of the company are seasonal. This implies that the analyst will have to make adjustments on figures so that they can be compared with other firms. Activity ratios on the other hand use outdated data that can not indicate the current position of the firm, making it difficult to make meaningful information. Use of leverage ratios also faces the limitation of having no ability of differentiating company assets by their riskiness, meaning that risk-based capital requirements like those in Basel I and II may encourage firms to develop a risky balance sheet. Lastly, profitability ratios are based on short-term profits that might be achieved through cost cut without necessary justification that might end up affecting the company's long-run profitability (Epstein 2014).

Question 2

The main ideas that should be presented to shareholders in an annual report include a summary of financial information mainly financial data including mutual funds as well as operating conditions. In addition, the presentation should include auditor's reports (Epstein 2014). I think these ideas should be included because the financial performance data will enable the management to compare current and previous information and make forecast for future periods. More emphasis should be in areas with increased earnings to show the possibility of increased shareholder wealth distributions. This is important as it impacts shareholders positively and attract prospective investors. The auditor's report is necessary as should be provided as it provides the auditor's opinion on challenges, opportunities available and already lost opportunities in the firm. The operating conditions including legal issues that

outlines taxations and compliances. This information is important in assuring shareholders that the business is apart from complying with laws; it is also a good citizen corporate.

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References

- Epstein, L. (2014). *Financial Decision Making: An Introduction to Financial Reports*. San Diego, CA: Bridgepoint Education, Inc.

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